Canadian Investment Review

How the IMF Hampers Economic Recovery

Iceland didn't take the money - and now it's on the mend.

BY Scot Blythe | May 16, 2011

While PIIGS has become a clever term for the debt-troubled countries on the periphery of Europe, there is one that is not like the others. Of that collocation of countries, Portugal, Ireland, Iceland, Greece and Spain, hobbled by debt in various ways – some of it government, some of it financial sector – Iceland stands apart.

Iceland has fallen on hard times, but it has its own currency. Its banks melted down, but it didn't opt for an IMF bailout. That makes all the difference, says Alex Jurshevski, managing partner at Recovery Partners in Toronto.

"There's a lot of palaver and chat about these bailouts," says Jurshevski, who was involved in turning around the New Zealand government's portfolio management operations in the early 1990s. He has also served on the Advisory Panel on Government Debt Management and the World Bank's Government Borrowers Forum. "Rather than enabling a restructuring to occur, what the IMF and the authorities are doing is trying to enforce the existing debt contracts and force governments to continue maintaining debt loads at current levels because the prospect of an actual restructuring on the scale required would mean significant losses at major banks globally."

Investors in sovereign debt are rightly concerned about getting their money back. They fear another Argentina, where sovereign debt was repaid at a quarter to a third of its nominal value. Jurshevski, speaking last week in Toronto at a forum on exchange traded funds sponsored by Radius Financial Education, thinks that banks that made "foolish" loans have to accept a haircut. The bailouts – such as Ireland, Greece and Portugal have accepted – are simply a patch that leaves the instigating problems unresolved.

"What happens with that debt patch," he argues "is that you cede control of your economy. Your spending powers, your taxation powers are all handed over to outside agencies…. You're sitting in the teacher's office, you've got to do your homework under supervision and you're not going to be let out of that office until you've completed the assignment."

While Iceland faces significant economic travails, nevertheless it has retained its freedom to act. "Iceland was on the ropes," he explains. "Our message to the Icelanders was don't take the loans, don't take the IMF package — don't, don't, don't – but keep your currency. The Icelanders now are coming out of their process, clearly there's a lot of wood to chop … But their economy is starting to respond, largely because they allowed the exchange rate to adjust. They took a big chop, incomes have fallen, there's high unemployment, but the prospects for recovery are far better because they don't have the millstone of all this additional debt."

For Jurshevski, bailouts, while ensuring a flow of credit, only prolong the misery. Iceland seems to have shortened the period – or at least the prospective period – of fiscal pain by not taking on additional debt.

“There was, given the capital controls, a big stock of trapped ‘glacier’ bonds – bonds issued by the Icelandic authorities and others – owing to the ECB, Paribas and other banks,” he notes. “The rationale for the IMF package and the Nordic package was to get this money into the country so that it could be shovelled out the other side and get the glacier bonds paid out at par against the euro when in fact the Icelandic króna had fallen by 60%. None of that occurred. The Icelanders are on the road to recovery. Now contrast that with Greece, which took the package, they’ve now got significant social stresses in that economy and it doesn’t look like this package is going to have any long-term run rate on it.”

That leads to a key question. How can countries avoid a debt wall in the first place? Austerity is not the first answer, Jurshevski argues.

“What you need to have is a comprehensive risk management approach. The key thing about what we did in New Zealand is that we spent a lot of time on relationship management. Relationship management with both the rating agencies, relationship management with investors.”

But that’s only part of it. Relationship management only works if you have disclosure, lack of which got Greece into its present mess. “What got Greece into trouble? Oh gee, you’ve got $25 billion of off-balance-sheet debt. Well obviously someone in the debt office thought this was a good idea at the time to do this trade with Goldman Sachs, to hide $25 billion in liabilities. The Ministry of Finance and the government of the day probably that it was a great idea because it enabled them entry into the EU. But all of a sudden the chickens are coming home to roost. Well that’s an example of not adhering to best practices.”

Beyond that, he argues, you have to acknowledge that once your credit rating drops, you have to seek out other potential lenders. If “you see yourself sliding down the slope, you better get on your horse and start road-showing and making sure that your economic story with the best possible gloss is getting out to the right investors that are able to invest in your paper. In most cases, investors that you’ve cultivated in the past, the banks and other investment funds, only focus on investment-grade paper. You don’t want to talk to them, you want to shift your focus entirely and that, in many cases is not well understood. It’s also not well understood by many of these governments that they lose the ability to talk to the market when you get in bed with the IMF.”

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